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Common Error No. 40 [1]

Written by **Dr Madsen Pirie** [2] | Wednesday 20 February 2008

40. "The free market does not work in practice because there is no such thing as perfect competition or perfect information."

The free market needs neither perfect competition nor perfect information. It works on the basis of what there is. Textbooks might talk of such things, and they might be used to make pretty equations and graphs, but they have nothing to do with the real world.

In the market place there is competition all the time. Sellers are competing to sell products at different prices, and buyers are bidding to buy them. When supply is abundant, sellers might have to undercut each other to get their goods sold. When goods are in short supply, customers might find themselves bidding against each other to obtain them. This goes on constantly, changing from day to day and even from moment to moment as new information emerges. None of this has anything to do with perfection. It is a continual process in which available information is acted upon. It does not have to be perfect; all it has to be is better.

Textbook economists might talk of 'equilibrium prices' at which supply matches demand, but no-one has ever seen such a thing in the real world. On the contrary, prices are changing constantly and vary at different times between different types of seller and between different locations.

Some people take the 'imperfection' of markets as a signal to advocate central planning and state direction. They want intelligent minds to supersede the confusing jumble of market interactions and impose a rational order on things. But there is no such thing as perfect planning either, and attempts to plan economies have proved laughably inferior. They have less information, less motivation, and are less responsive. Comparing the record of free markets, imperfect as they are, with planned economies and their imperfections, one sees the market economies winning hand over fist.

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